Topic 15: Home Ownership

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I. General Concepts

A. Home Ownership Rates in the U.S.

Buying a house to live in is the largest purchase that many people ever make. The proportion of American families that own the residences they live in has been generally in the 60 to 70% range in recent decades. U.S. Census Bureau data show that the figure rose from approximately 66% in the late 1990s to a high of almost 70% in the easy-financing 2004 – 2005 period before the subprime mortgage lending and housing crisis, to a low of about 64% in 2014 – 2016, back up above 67% in late 2020 and then slightly down to 66% in early 2023, though only about 38% of Americans below age 35 were owners. Fewer available homes and increased interest rates leave the U.S. housing affordability index in late October 2023 at a forty-year low.[1] Concerns also have been expressed about low minority home ownership rates; in June of 2022 Habitat for Humanity directed a $436 million donation from MacKenzie Scott, the billionaire ex-wife of Amazon founder Jeff Bezos, toward its Advancing Black Homeownership initiative, which has the goal of getting three million new families into owned homes by the year 2030.[2]

[In summer 2022 Freddie Mac estimated that the U.S. had a housing shortage of 3.8 million owned and rental units. Construction had lagged for reasons that included skilled labor shortages dating to the 2000s mortgage lending crisis, high costs for land and for lumber and other building materials, costs of meeting zoning and other regulatory restrictions, and remote workers' desire for homes that were bigger and located farther from traditional job centers. Results included sales at prices considerably above asking prices and the waiving of common buyer protections like inspection clauses. A *New York Times* report stated that despite more housing construction under way than at any time since the 1970s, it would still take years for building activity to reach the needed supply. But then by fall the market slowed considerably, with oversupply of newly built units in some areas, as interest rates continued to rise.]

How do U.S. figures stack up against the rest of the world? December 2018 figures show that Canada (known for high housing prices in its larger cities), the U.K., Australia, New Zealand, Ireland, Israel, France, the Netherlands, and Sweden had home ownership rates not too far from ours. Some countries with advanced economies had rates noticeably lower (Switzerland 41%, Germany 51%, South Korea 58%, Denmark 60%), while Belgium and Luxembourg averaged a few percentage points higher. It is interesting that the highest home ownership rates often are seen in countries viewed as having developing economies: Czech Republic (also Iceland) 79%, Bulgaria and Poland 84%, Russia 87%, Slovakia and Croatia 90%, Singapore 91%, and Romania 96%. One source suggests that the U.K. rate exceeds Germany's because while both countries did much rebuilding after World War II Germany promoted a robust rental market, while the U.K. restricted the rental market so much that more people ended up buying houses. And reported rates could be affected by the fact that "ownership" rights in other parts of the world , particularly former communist countries, may differ from the type of ownership that we know.

In case you wondered: the most expensive single-family residential real estate transaction ever in the U.S. was hedge fund Citadel LLC and trading firm Citadel Securities founder Ken Griffin's $238,000,000 purchase of a 24,000 square foot condominium unit at 220 Central Park South, on "Billionaire's Row" in New York City, in 2019. In 2022 Griffin moved Citadel's headquarters from Chicago to Miami, citing Chicago's crime problems and Florida's favorable business climate, relative to that of Illinois. Griffin had been the wealthiest resident of the Land of Lincoln, with an estimated $25,000,000,000 net worth; his $58,750,000 condominium purchase in 2017 (actually separate purchases of the top four floors of a Walton Street Gold Coast building that he planned to combine into one living unit, but ultimately never did) also represents the highest price ever paid for a residential property in Chicago. Another noteworthy high Windy City price involved the September 2022 purchase of a 10,000 square foot unit on the 71st floor of the wavy-looking 101-story St. Regis Tower, at Lake Shore and Wacker, for more than $20 million.

Interesting tidbit: in the post-Civil War period Chicago had more home owners than any other U.S. city. A house could be built for as little as $400, thanks to abundant wood from the upper Midwest's forests – and these wooden structures burned quickly when fire engulfed the city in early October of 1871.[3]

B. What Is Ownership?

The popular press and even textbooks often assert that people take satisfaction or pride in being home owners. But the phrase "pride of ownership" really is just a benign but meaningless marketing buzzword, although the argument that people who raise such an issue may be wanting to make has some serious financial implications.

Ownership is the right to residual values; how can someone take *pride* in *a point in risk/return space*? (Should those whose risk/return preferences lead them to be non-owners, such as lenders or lessees, of a particular property be ashamed?) And it certainly makes no sense to say "the bank actually owns your house" when a buyer borrows most of the purchase price. Imagine that a buyer borrows $160,000 toward paying for a $200,000 house. Shortly after the purchase local real estate prices plummet when the biggest local employer closes, and the buyer must move but can sell the house for just $165,000 when so many other local residents are selling their houses and moving; how much of the accompanying loss does the bank take? Or shortly after the purchase the local market soars and the buyer decides to sell and ends up getting $235,000; how much of that gain does the bank get?

The answer in both cases is none; the bank is a lender, receiving a fixed financial return (the agreed-on interest for the period when any principal remains owed, and the eventual return of its principal); the owner's financial return consists of whatever is left after all other parties are paid. Think of how the price payable to the seller is distributed at the closing in the typical house transaction: the seller's lender is repaid, the seller's broker and attorney are paid, the buyer (in Illinois) is paid in advance for property taxes the buyer will be billed for but that apply to periods when the seller still was in residence, any other fees owed by the seller are paid, and then the seller gets to keep the residual that remains – whatever is left after all other affected parties' claims have been met.

A much more useful expression would be the *greed* or *enlightened self-interest* of ownership. People who live in rented houses or apartments care about the local schools if they have children, and about other quality of life issues while they are residents – but if problems arise, then with relative ease and at fairly low cost renters can simply move from the jurisdiction when their leases expire. Thus a renter, especially one with no children, has little incentive to spend time and resources banding together with others to address issues like schools and crime that must be handled community-wide. But anyone who owns a home has financial incentives to care about these kinds of issues, because the residual received on resale will be affected by buyers' feelings about the area's desirability. Home owners have direct financial incentives to do their part, and join with others, in attending governmental meetings, hosting events where neighbors can talk, and volunteering or donating to political campaigns to maintain schools and other aspects of quality of life in the community, even if they have no children and plan to move away shortly. If they do not, then their residual values – the prices they receive upon selling their homes – will suffer, just as if they had not maintained the roofs or foundations or other physical components of those owned dwellings.

We address issues like this one not to nit-pick over definitions, but rather to better understand the *ownership* concept. (People tend to know what *pride* is; it is *ownership* that they do not understand.) If we, as a society, choose to enact or discontinue policies that promote home ownership, then we need to come to terms with what ownership is. The U.S. government actually takes steps to encourage home ownership; we saw examples in our mortgage lending discussion of 1) federal support for the secondary mortgage market through federal government-sponsored enterprises (Fannie Mae, Freddie Mac) that keep interest rates lower by providing liquidity to the parties that lend in primary mortgage market transactions, and 2) support for borrowers in primary mortgage market transactions through federal agencies (FHA, VA, USDA) that help home-buying borrowers who lack strong savings balances or credit histories. [Those who view support for home ownership as an appropriate application of federal government power and resources feel that communities benefit when residents have long-term commitments – which owners are incentivized to have, even if they plan to move away soon, as noted in the paragraph above.] In addition, there potentially are federal (and sometimes state) income tax breaks for home owners.

But the concept of the "homestead," the necessity of having a place to live, receives favorable treatment under the law beyond better loan terms and the income tax benefits discussed below. For example, in Illinois and some other states the owner-occupant of a residence pays less in property tax than does the owner of a rental residential property with an equal market value assessment. (One court held that an owner should pay the lower homestead tax only on part of his assessed value because he had a tenant renting a specific part of the house, with its own bathroom and kitchen and doorbell, although sharing the entire residence with a renter would seem to have met the court's homestead standard. The home owner argued that his situation was similar to that of someone working from home, who does not lose the homestead benefit, but the court said the work in that case is done at a property that is clearly the owner's whole residence. It required him to reimburse the county for ten years of underpayment.[4]) A party that is owed money normally has a "judgment lien" against a debtor's real estate, but the ability to force an auction sale to generate cash is reduced if the real estate is the homestead of the debtor, or of the debtor's legal spouse; even if the creditor can force a sale the owner can keep $15,000 of the sale proceeds ($30,000 for married owners). Interestingly, both the reduction in the value taxed and the amount of value retained by the owner in a judicial sale are called the "homestead exemption." The spouse's homestead rights help to explain why transaction documents sometimes identify the marital status of a home seller or a mortgage borrower.

II. A Quick Overview of U.S. Federal Income Taxes

What follows presents your elderly instructor's understanding of some key features of our U.S. federal income tax laws and procedures, provided to give some insights into how home ownership has long benefited under our country's income tax policy. It is to be viewed as a general story and not as providing specific advice on any tax-related topic. Tax laws are complicated and can change, and even established laws can be interpreted differently by different courts; if that were not the case then a lot of lawyers and appellate court judges would starve to death.

There are three branches of the U.S. federal government: the legislative branch passes laws, the executive branch enforces them, and the judicial branch interprets them. The legislative basis for our U.S. federal income tax is the Internal Revenue Code, initially passed by Congress in 1954 and frequently updated in the years since. But legislation often has gray areas that can not be foreseen (or that Congress decides to leave vague) and must be sorted out, and the initial job of handling those questions falls to the Internal Revenue Service, a division of the executive branch's U.S. Department of the Treasury, which issues Regulations on how the laws will be enforced. Law school income tax courses cover both the "Code" (what the written law says) and the "Regs" (what the party charged with enforcement says it will do in administering the written law and addressing the gray areas – trying to best balance what is sensible, fair, workable, and in keeping with the way related tax questions have been settled in the past).

Then sometimes a taxpayer who feels that the IRS's take on the written law is incorrect, or that the written law itself violates the U.S. Constitution, decides to take matters to court: the judicial branch that interprets the written law. A federal income tax case can be heard initially by a regular federal district court, a special U.S. tax court that deals only with income tax cases, or the U.S. Court of Claims, which is where people sue if they feel that the government owes money to them (as when someone questions what the IRS said was owed, and seeks a refund after paying).

Decisions by those courts can be appealed to the federal appellate courts, and then sometimes cases involving major federal income tax policy questions end up being heard by the U.S. Supreme Court. In the 1955 *Commissioner v. Glenshaw Glass Company* case the Supreme Court provided a great definition of income; essentially, income is an increase in wealth, fully realized, and under the taxpayer's control. And in the 1934 case of *Gregory v. Helvering* federal district court judge Learned Hand (who would later serve on the Supreme Court) said there is nothing patriotic about paying more in income tax than the minimum amount the tax laws allow you legitimately to pay.

The big-picture conceptual technique for computing personal federal income taxes is as follows (the step-by-step procedure used with IRS tax forms is slightly different in some of the applications). Essentially you start with that realized increase in wealth, but then are permitted to subtract out various items in determining the final amount on which U.S. federal income tax must be paid.

- *Gross Income* (essentially all income received from any source, other than excludable items)

[Pay from your job, dividend and interest earnings from investments, gains from selling something (including Taylor Swift tickets) at a profit, alimony received if the divorce occurred before 2018, debts forgiven, retail value of prizes won, gambling winnings net of losses, money you find all are forms of income that *generally* are taxed. Not too many items are excludable; among those that are: a portion of dividend ("qualified") income, interest earned on municipal bonds, dividends/interest earned on a Roth retirement savings account (income tax is deferred, not excluded, on earnings from non-Roth retirement plans), life insurance proceeds, true gifts, *money collected from renting your home for two weeks or less per year*, money withheld for an employer-managed plan to pay medical or dependent care expenses.]

- Minus *Adjustments*

[Adjustments, subtracted "above the line," often involve expenses incurred generating income as a self-employed person, but other examples are non-Roth IRA contributions up to the permitted annual limit, K-12 teachers' unreimbursed costs of buying supplies/ equipment up to $300 per year, student loan interest paid ($2,500 annual limit), alimony paid if the divorce was pre-2018, interest penalties for early savings withdrawals.

- Equals *Adjusted Gross Income* (AGI – basically the household's total available income)

- Minus *Deductions* (standard or itemized)

[Deductions, subtracted "below the (AGI) line," can potentially include amounts paid for *home mortgage loan interest*, *local property tax*, state income tax, donations to 501(c)(3) charitable groups (political donations are not deductible), medical expenses in excess of 7.5% of AGI. A *standard deduction* can be claimed with no records or

justification needed,[5] but those with deductible amounts that exceed the standard deduction can keep careful records and *itemize* their deductions to further reduce the taxable incomes they report (the return filer submits *Schedule A* to report the list), and thereby save additional money on their federal income tax bills.]

Outlays to charities are deductible only for itemizers, and only if they reflect a "detached and disinterested generosity" per U.S. federal courts (can not be given primarily to benefit the donor or any specific individual), and are deductible only to the extent that amounts given exceed the value of services or goods received in return. So Girl Scout Cookie purchases generally would not be deductible, and if a qualified charitable organization holds a fund-raising dinner or similar event it will send the attendee a receipt showing the deductible amount as the price paid for the ticket, minus the estimated market value of food and service, swag, and other items received in return.

- ~~Also Minus *Personal Exemptions*~~

[Before 2018 the taxpayer could subtract an amount called an *exemption* that further reduced taxable income, applied to each household member supported by the family income; that amount was $4,050 per person for 2017 returns. In late 2017, with passage of the *Tax Cuts and Jobs Act* (TCJA) Congress eliminated personal exemptions, but also increased the standard deduction, reduced income tax rates, and increased the *credit* (see below) that can be claimed for each minor child in the household.]

- Minus 20% of "Qualified Business Income" (*including dividends on Real Estate Investment Trust shares*)

- Equals *Taxable Income*

- Times Average Tax Rate

IRS provides pre-computed tables based on filing status for some income ranges; income levels to which particular rates apply are adjusted every year so that a filer generally does not pay a higher percentage of income as income tax just because of inflation-based income gains.

- Equals *Initial Federal Income Tax Liability*

- Minus *Credits*

[A credit is like a super-deduction: a deduction reduces the income on which tax is paid, while a credit directly reduces, dollar for dollar, the tax paid. Examples are earned income credit for a lower income individual providing for a dependent child, child tax credit for any taxpayer with a dependent child under age 18 (typically $2,000 per child; $500 for disabled dependent 18 or older), dependent care credit for paying for a dependent child or perhaps elderly parent to be cared for while the taxpayer works, *residential energy* credit are examples.]

- Equals *Final Federal Income Tax Liability*

Each taxpayer declares a filing status: Married filing jointly, Married filing separately (can sometimes cost more in tax but releases each spouse from legal obligations under the other's income tax return), Head of household (single person providing a home for a dependent), Single. Filing status establishes limits on certain deductions and determines the percentage of income that is to be paid as tax. Our marginal income tax rates are *graduated* to some degree, with a higher percentage of income paid in tax as successively higher income levels are reached. Since World War II employers have withheld from pay checks estimates of taxes their employees will owe (based in part on input from employees), and forwarded the estimated taxes to the federal government. By April 15 of each year we all file federal (and state) income tax returns for the prior year, to finalize the paper work and pay amounts that remain owed (or get refunds if employer withholding and other amounts we prepaid exceed the true tax bills).[6]

III. Financial Costs and Benefits of Home Ownership

A. Some Financial Costs

1. No periodic returns (dividends, interest) are earned on the equity in an owner-occupied residence (and buying a more expensive home might mean having even less money in accounts that would earn dividends or interest).

2. Illiquidity of investment – capturing the equity by selling can involve long waiting times and significant transaction costs.

3. Maintenance expenses (leaky faucets, broken windows) involve commitments of money that do not provide measurable financial returns (while failing to make needed repairs could lead to significant eventual losses).

4. Even major improvements to a home usually can not be fully recouped in higher resale prices. Every year *Remodeling* magazine provides cost *vs.* value estimates for various renovation projects; 2023 figures show that a master bedroom suite addition increases home value by less than 25% of the cost, while a major kitchen or bathroom remodel increases value by less than 40%.[7] The only project that has consistently come close to paying for itself in recent years is a fairly inexpensive garage door replacement, which surveyed builders have said will increase resale value by close to or slightly more than 100% of the cost of having the job done.

5. Real estate prices do not always go up, the way some observers foolishly believed they would prior to the 2006 – 2008 mortgage meltdown. We have seen some big movements over recent decades, with prices rising appreciably in the late 1970s and early 2000s, but falling somewhat in the early 1980s and abruptly in the late 2000s. And property taxes and transaction costs can offset inflationary gains (non-standardized assets like real estate and art objects tend to have high transaction costs). Of course the 2020 – 2021 Covid period and its aftermath was characterized by very high appreciation in nominal home prices; the Corelogic Case-Shiller National Home Price Index showed a record-high increase of just over 20% from March 2021 to March 2022 (the government's mortgage lending regulator Federal Housing Finance Agency showed a 19% gain in average home prices over that period, and the median price of previously owned U.S. houses rose above $400,000 for the first time in May).

[Both the Case-Shiller and FHFA indexes measure price changes based on earlier and later sales of the same residence. Corelogic maintains indexes based on the Case-Shiller methodology for the country as a whole, a 20-city grouping, a 10-city grouping, and the individual included cities.] Reasons behind the rise were believed to be ever-increasing land values in desirable locations, rising demand from people wanting to move to bigger or more distant houses for remote work,[8] reduced supply as the shutdown curtailed building activity, increased costs for construction materials and labor, record low interest rates that allowed buyers to bid high prices and still keep their monthly loan payments affordable, and in some areas rents so high relative to mortgage loan payments that sellers would take their houses off the market to rent out (or potential owner-occupants were outbid by landlords). Market observers sometimes suggest three years as a rule-of-thumb holding period to allow inflationary gains (based on averages observed over time) to exceed these costs, but of course whether three years is appropriate depends on economic conditions at the particular time and in the relevant location.

6. We sometimes hear, "buy a house less expensive than others in its neighborhood, because then the higher valued properties around it will bring its value up." That statement makes no sense; if the advice is correct, then will the person who buys it not pay a price that reflects the value already having risen through the influence of what is around it? If the phenomenon holds true, then it seems whoever had the house built would have captured the resulting gain – but that is if such a potential for gain ever even existed.

7. A home owner might not really benefit from higher local property values. An increase in value from $200,000 to $250,000 for someone's residence does that individual little good if he or she plans to remain living there, or even if wanting to move – because it likely will cost $250,000 for an equally desirable home in a different location, in or out of that town. The eventual result might be just an increase in assessed value and property taxes. Benefiting in real terms would seem to require conditions such as wanting to move from one location where housing values have risen a lot and relocating to one where values have risen less, like if conditions that increase values in the first area (a large company opens a new production facility?) are not more widely experienced; good luck being able to plan that. There arguably is a liquidity benefit, in that the owner would have more home equity to borrow against. Let's say that someone who currently has no debt financing wants to borrow 80% of her home's value. If she thinks it is worth $200,000 then she expects to be able to borrow $160,000, but if the appraisal shows a value of $250,000 then she can borrow $200,000. Of course it all must be paid back, with interest, but the typically low interest rate (relative to what would have to be paid for other, especially non-secured financing) on a note secured by a personal residence might make such a loan especially attractive to someone in a liquidity bind.

B. Some Financial Benefits
Many of the financial benefits of home ownership relate to a possible reduction in federal income taxes that a home owner can realize relative to someone with equal income who rents a home that provides similar real estate services; notice the role that home ownership plays in the potential deduction and credit areas in the income tax breakdown shown earlier. For income tax purposes generally a "home" can be any dwelling place, including a proportional share of a cooperative building, or even a house boat or mobile home, that has *sleeping quarters*, *bathroom facilities*, and *cooking facilities*[9] (one source indicated that *electrical power* also usually is required).

1. *Interest* paid on money borrowed to *buy, build, or improve* a home (deductible since 1913, when a broadly applicable federal income tax was enacted), and local *ad valorem property taxes* paid in connection with home ownership, are *deductible* in computing the income on which federal income tax is paid. Historically it has been unusual for anyone who was not a home owner to be able to benefit from *itemizing* deductions from adjusted gross income in determining taxable income, because the other potentially deductible expenditures (primarily state income taxes, charitable contributions, and excessively high medical costs) were not that high for most families, but adding in several thousand dollars in home loan interest and property taxes could raise allowed deductions above the *standard* amount, leading to some federal income tax savings if Schedule A is submitted. (The annual increase in principal owed due to negative amortization on a reverse mortgage loan is not deductible interest; recall that money from a reverse mortgage loan is not used to buy, build, or improve the borrower's home. A loan to purchase a spouse's share of a house in a divorce does count as a loan to buy, on which interest is deductible.)

Think of a married couple that, in 2017, paid state income tax of $3,500, gave $5,000 to charity, and did not have any big uninsured medical bills to pay; if they lived in a rented dwelling the deductions they could account for would have been just $8,500 – while the standard deduction that every married couple could claim without any supporting justification was $12,700. So if AGI was $120,000 the pair's AGI minus deductions would be $120,000 – $12,700 = $107,300 – the same figure we would see if, for example, they had given nothing to charity. But if they lived in an owned dwelling unit on which they paid $6,000 in mortgage loan interest plus $4,000 in *ad valorem* property taxes (costs we might assume the landlord would pass along to them in the rent paid for a similar house, but that a renter could not deduct), those home-related deductions added to the non-home ownership permitted deductions would take the total deductible amount to $8,500 + $10,000 = $18,500, and they would itemize and have AGI minus deductions to pay income tax on of a lower $120,000 – $18,500 = $101,500. These costs of home ownership would have reduced their taxable income by $5,800 relative to claiming the standard deduction, thereby actually giving them an income tax benefit from the charity donation (when combined with their deductions from home ownership).

However, the marginal value of these traditional income tax benefits from home ownership is not nearly what it used to be, at least for many (especially if married) taxpayers. The Tax Cuts and Jobs Act, passed in late 2017 as noted earlier, increased the standard deduction by so much (essentially doubling it, from $12,700 in 2017 to $24,000 in 2018 for married couples filing joint income tax returns) that far fewer Americans will lower their taxable incomes with these expenditures by itemizing in tax filing years 2018 onward. (The proportion of U.S. households itemizing deductions on personal federal income tax returns dropped from 31.1% prior to TCJA's passage[10] to an estimated 10% as of late 2023.[11]) If the couple discussed above had the same income and expense items in 2018 as in 2017 (including the mortgage loan interest and property taxes as home owners), the payments would have totaled $18,500, but a standard, no-receipts-to-keep/no-questions-to-account-for deduction of $24,000 was already built into the system for them. So these costs of home ownership did not reduce their taxable income at all relative to claiming the standard deduction.

A couple would have to pay a lot of interest, along with perhaps giving very generously to charity and paying significant local property tax and state income tax (or having some serious medical costs not covered by insurance), to make itemizing deductions worthwhile; federal income tax is the same whether the potentially deductible amounts spent on state income tax + charity giving + unreimbursed medical + mortgage loan interest + local property taxes total anything up to $29,200. (Charitable organizations were especially concerned about how this change in longstanding federal income tax law would affect the future donations they would receive.) [The standard deductions for 2024 income tax returns to be filed early in 2025 are $14,600 for single individuals and $29,200 for married couples filing jointly ($3,100 higher for a married couple who are both age 65 or older).]

So: why not just buy a really expensive home by borrowing a lot of money, and then paying a ton of property tax on it, and claiming huge itemized deductions against adjusted gross income in reaching taxable income, thereby letting Uncle Sam pick up a portion of the cost of owning a luxury residence? Because the TCJA changes also placed some notable limitations on what can be deducted even by a taxpayer who itemizes. Before 2018 a married

couple or single person could deduct interest paid on up to $1 million borrowed to buy a house *plus* interest on up to another $100,000 in "home equity" debt, even if the proceeds were used to pay for something unrelated to home ownership (unless placed in an investment that generated tax-free income). So it was not unusual for people to borrow at low, secured mortgage loan interest rates against their houses' equity (resulting from increasing values and/or principal having been repaid on an initial loan), and use the money to pay down higher-interest credit card debt, or pay college tuition or buy a new car. This provision led observers to say that "your house is your bank."

Now, however, the interest paid on debt secured by home equity can be deducted from adjusted gross income only if the borrower uses the proceeds to make home repairs or improvements, and interest is deductible on no more than $750,000 in total debt secured by a first and/or second residence (note that it is the amount of principal on which interest is paid that is limited, not the amount of interest paid, which will also depend on the interest rate charged). [The limit on principal applies to a married couple or a single individual, such that unmarried co-owners of one or two homes can together deduct interest paid on up to $1.5 million in debt secured by home value. And the mortgage must be recorded with local county records officials for the interest to be deductible, interesting trivia. The principal limit is not adjusted for inflation; it has remained at $750,000 since 2018.]

Discount points paid on a mortgage loan to purchase a primary residence are deductible as interest in the year when they are paid if they are computed as a percentage of initial principal (in keeping with the $750,000 principal restriction) and are reasonable in amount per local lending practices – even if the home seller pays those points! [Points wrapped into the amount borrowed, paid on a loan secured by a second residence, or paid to refinance a loan usually must be deducted proportionally over the new loan's life – but the remainder can be deducted all at once in the year such a loan is repaid, and a refinancer who borrows extra money to improve the home can deduct the points paid on the excess.

Points paid for specific services can not be deducted; IRS is wise to the possible ruse of paying more in "deductible" points in return for not paying non-deductible appraisal/title fees. Points paid on a loan for income-producing real estate must be "amortized" on a straight-line basis over the loan's term.] Mortgage insurance premiums paid (FHA, PMI) also were deductible as a form of interest, reported to the taxpayer by the lender on Form 1098 with other mortgage loan interest information (the deduction's availability phased out as income increased, with no deduction allowed if the home owner's AGI exceeded $109,000, and the deduction ended with the 2021 tax year).

But won't a McMansion with a hefty property tax bill bring the home owner back into itemizing territory even if the deductibility of interest paid is limited? Maybe not, because the TCJA changes also reduced to $10,000 the amount that can be deducted for *all* state and local taxes (SALT) combined (an amount not regularly adjusted for inflation; it has stayed at $10,000 since 2018), so now state income taxes and local property taxes go into the same bucket. (The reasoning for the change was that residents of states that charge low taxes and provide less intensive public services should not have to subsidize, through their federal income taxes, the more intensive public services provided by state and local governments that charge higher taxes – recall the Tiebout hypothesis. As of fall 2023 Illinois had the second-highest property tax rates in the U.S., median rate 2.231% of value, , trailing only New Jersey.[12]) So in 2018, someone who paid $3,500 in state income taxes and gave $5,000 to charity, and owned a house so expensive that they paid $9,000 in mortgage loan interest and $14,000 in local property taxes, would have been able to justify deductions of only $5,000 + $9,000 + ~~$3,500 + $14,000~~ (limited to $10,000) = $24,000 – which was the standard deduction that could have been claimed with no need for records or receipts (or having spent even one cent for charity, mortgage loan interest, or property taxes – think of a couple living rent-free with relatives). (Topic 15 spreadsheet problem on the web site deals with SALT taxes and the standard deduction *vs*. itemizing.)

[Reduced federal income tax benefits from paying high state income taxes have led some people to move, or at least claim to have moved, from states with high (New York) to low (Florida) state income taxes. Such a household is subject to a *residency audit* by the state it moved from, to assure that a true move has occurred and not simply the recognition of income at a new address. Failing the audit means paying income tax in the original state. Among issues examined: time spent in the original state (phone records can be subpoenaed), where valued personal items are kept, where vehicles are registered/driver's licenses obtained, where main medical service providers are located.]

Yet the owner of a fairly expensive residence still might be able to benefit from itemizing (get some added income tax breaks and thus enjoy a home ownership subsidy from the federal government). Consider the numbers from the previous example; there we may have been assuming that the home owner did not have a large mortgage loan principal balance – note that if the interest rate was 6% per year then $9,000 paid in interest would suggest only about $150,000 in principal owed coming into the year. If the home owner owed the maximum allowable $750,000, then a 6% annual interest rate would accompany about $45,000 in interest paid for the year, and total deductible

amounts would add to $5,000 + $45,000 + ~~$3,500 + $14,000~~ $10,000 = $60,000, reducing taxable income by $36,000 more ($60,000 *vs*. $24,000) than would occur with the standard deduction alone. If the marginal income tax rate was 25% then the federal government would be paying for approximately .25 x $36,000 = $9,000 of this household's desire to support charities and own a more expensive home. (The standard deduction for single filers was a lower $12,000 in 2018, and while that was up from $6,300 in 2017 we still might see single owners of fairly expensive homes being able to save on income taxes by itemizing, since $10,000 in allowed SALT expenditures plus the interest on, *e.g.*, $490,000 in home mortgage loan debt would be far above a post-2017 standard deduction.)

Regular property taxes are fully deductible (subject to the $10,000 SALT limit) by owners of traditional homes, and by condominium unit owners. There seems to be no limit on the number of "homes" for which these taxes can be deducted, since the deduction applies to any real estate owned but not used "for business." The owner of a unit in a cooperative building is permitted to deduct a share of the total property tax paid, unless the corporation just leases the land and agrees by contract to pay the property taxes. Reason: to be deductible, the *expense must be a legal obligation of the taxpayer*. In a long-ago case a daughter went to the local courthouse and paid her elderly mother's property taxes, and then claimed a deduction against income for federal income tax purposes. But the daughter was not eligible for a deduction because the tax was not her obligation to pay, and the mother could not deduct the tax because she did not actually pay it. (The daughter should have given her mother a cash gift; then the mother could have paid the tax and claimed a deduction on her own return, at least if she itemized.) Also be aware that a new owner can not deduct property taxes paid for prior years, if those taxes were paid with cash provided at the closing by the seller, as in Illinois (that previous owner would have the right to claim deductions for those periods).

Special assessments are deductible *if* they pay for *maintenance* items that are not expected to increase the property's value (IRS instructions give example of a special assessment for repairing, rather than initially installing, sidewalks). Related interest payments also are deductible, if the special assessment is paid for in installments and the owner is charged interest. Special assessments for value-enhancing improvements (*e.g*., county paves a road that was dirt before) are not deductible, but rather increase amount the owner is deemed to have invested in the home (its *basis*).

2. The capital gain on a home sale (from reselling a principal residence – not an income-producing property – at a price higher than the owner's investment, or "basis") gets favorable income tax treatment. (An owner's basis includes the direct price initially paid, purchase-related costs like title work/recording fees/utility hook-ups, and major subsequent work that prolongs the improvements' life and adds value, like landscaping or a new roof or siding, or something even bigger like adding a new room.[13]) In fact, unless the gain exceeds $500,000 for a married couple filing a joint return ($250,000 for singles), there is never an income tax to pay, unless the home owner sells at a gain less than two years after a previous sale involving an untaxed gain. (A widowed individual can claim the higher $500,000 amount for up to two years after the deceased spouse's death, and half of the residence's cost basis is "stepped up" to the value on the date when the departed spouse died, further reducing taxable gains if the property has risen in value over the years. The $500,000 and $250,000 are not adjusted for inflation; those specific amounts have remained unchanged since 1997.) The seller is required to have owned the residence for at least two years, and to have lived in it for at least 24 months over the previous five years.

(And a home sale gain above the $500,000/$250,000 limit counts as *net investment income* on which a seller with AGI above $250,000/$200,000 must pay an added 3.8% net investment income tax (NIIT). So if a couple sells their house for a $650,000 gain then $150,000 counts as net investment income, and if their other net investment income is $60,000 they have $210,000 in net investment income. If their AGI is $320,000, which exceeds the $250,000 AGI limit by $70,000, then they owe extra income tax of .038 x $70,000 = $2,660.)

No personal asset class other than an owned primary residence allows someone to sell for a price exceeding what has been invested and escape owing a tax on the capital gain. If Mr. and Mrs. Redbird buy 5,000 shares of XCorp common stock for $200,000 and sell them three years later for $700,000 they must pay income tax on a $500,000 capital gain, even if they immediately invest the $700,000 in shares of similar company YCorp. But if they buy a $200,000 condo unit to live in and are able to sell it three years later for $700,000 just because the local real estate market has boomed, even with nothing having been spent to improve the property, they pay no income tax on the $500,000 capital gain (if they sold for $750,000 they would owe tax on a capital gain of the excess $50,000 beyond the allowed $500,000). (Canada does not tax any gain from selling a home that was the taxpayer's principal residence throughout the time it was owned.)

(If Mr. and Mrs. Redbird above never sell the XCorp stock then their children will inherit it with a basis "stepped-up" to equal the market value at the date of death for the later parent to die, such that they could inherit it and immediately sell it, no matter how much it has increased in value over the years, without recognizing a capital gain. The same treatment would apply if the Redbird offspring inherited the condo after it had risen substantially in value; if it was worth $850,000 at the death of the second parent to die the children would inherit it with an $850,000 basis and could promptly sell it for $850,000 without recognizing or paying income tax on any capital gain.)

On the other hand, selling a personal residence for *less* than the basis amount invested in it does not *reduce* the income on which the seller pays federal income tax; there is no income tax break for selling a home at a loss. (A house is a physically wasting asset that, absent increases in land or construction labor/material costs and/or substantial improvements made, should be expected to decline in value over time – and even a house that rises in nominal resale value over time generally has fallen in real value, relative to what a newly built house with generally similar features would sell for.) But if XCorp stock is sold for less than the total invested in it, that *capital loss* offsets capital gains earned on other investments sold, and a net of capital losses over capital gains can reduce the investor's other taxable income by up to $3,000 per year. (Realizing capital gains of $9,000 and capital losses of $17,000 eliminates taxes that otherwise would be owed on the gains for that year and leaves an added $8,000 net capital loss, with $3,000 reducing the filer's AGI in that specific year and the remaining $5,000 difference carried forward to offset $5,000 in capital gains, or to reduce ordinary income by up to $3,000 yearly, in subsequent years.)

Consider these situations. (I think the explanations are correct, and thank Dr. Rachel Birkey in ISU's Accounting department for insights, but nothing in our Topic 15 discussion should be construed as tax advice, and you should check with your own tax expert before taking any actions that have income tax implications.)

a) A married couple buys a habitable but run-down house for $112,000 and moves in. They hire a contractor to do major upgrades, paying $130,000 for materials/needed permits and $458,000 for labor, and two years after having bought the house, needing to move for a job transfer, sell it for $700,000 – which equals their basis of $112,000 + $130,000 + $458,000 = $700,000, so there is no capital gain to pay income tax on. But the couple not only has no extra money in their pockets; they need to have earned, and paid income tax at high ordinary income tax rates on, far more than $458,000 over past working years to have had $458,000 left to pay the contractor.

b) Our couple buys the habitable but run-down house for $112,000 and moves in. Over the next two years Spouse 1 keeps a regular job that provides cash and benefits, while handy spouse 2 spends 40 hours per week making major upgrades to the structure, and then two years later, with $130,000 spent on materials/permits, they sell the improved house for $700,000. Work done by owners does not increase the home's basis, but material and permit costs do, so their basis at the sale date is $112,000 + $130,000 = $242,000. The $700,000 – $242,000 = $458,000 gain on selling their principal residence does not exceed $500,000 (limit is $250,000 for a single person), so it is not taxed. Using their home, our couple was able to turn up to $458,000 ÷ 2 = $229,000 in average annual labor value, usually taxed at high ordinary income tax rates, into a fully untaxed benefit. (Part of the gain could reflect general housing price increases, of course. And there would be other costs of living in/maintaining a home, such as utilities and property taxes, but those would have to be met whether the property occupied needed work or not, even if rented and the landlord passed those costs to tenants in rents charged.) Then after selling they can buy another fixer-upper and repeat the untaxed gain process, as long as it is their principal residence and they live in it for at least two years.

[Even a scaled down project could provide a substantial economic benefit. A handy couple or individual pays $262,000 for a house with a badly outdated kitchen and main bathroom. They spend $28,000 for the needed materials (and possibly permits), and do the work in their spare time *while they live in it as their principal residence*. If the property with its $262,000 + $28,000 = $290,000 basis is sold two years later for $312,000 the $22,000 gain, which we will assume reflects the owners' labor value, is entirely untaxed. Then they can buy another house and fix it up while living in it, and sell for a gain two years later while being untaxed, once again, on their labor's value.]

3. A home owner is *not taxed on the home's imputed rental value*. This point may seem silly initially, because we also do not pay income tax on the imputed rental values of other owned assets, like cars or clothes or frying pans. (*Imputed* rental value is what you would have to pay, in theory, to obtain the use of an asset if you did not own it. The U.S. government bases the housing cost component of inflation in the Consumer Price Index on imputed or "owner's equivalent" rent, or OER: changes in what it would cost people to rent the homes they are living in.) But note that a home owner gets some investment-like treatment, such as potential loan interest and property tax deductibility, without the need to treat the related benefits as income. With all other assets you either get income tax

benefits but also must pay tax on some income (rental property), or else do not have to pay tax on actual or imputed income but also do not get any tax breaks (your car or other personal assets). [If you owned a house but rented it out to me, and I owned one but rented it to you, each of us would be an owner, each would have a place to live, each would get interest and property tax deductions (business deductions as landlords), but we also would be taxed on the rental income received. But if we sell to each other and live in our own homes, we both remain eligible for many of the same deductions without having to pay tax on any rental income.] ***A primary residence that you live in and own is the only asset that allows the potential for business-like deductions without an accompanying need to recognize income and pay an income tax on it.*** Admittedly TCJA's post-2017 substantial increase in the standard deduction, and accompanying lower likelihood of itemizing, reduced the value of this benefit for many people.

[A Federal Reserve publication explains that using imputed rents treats housing purely as a consumption expenditure, while an alternative would be to look at spending on owned housing as having an investment component, with a focus on monthly outlays for mortgage loan payments, property taxes, and home owners' insurance. This measure may better reflect owners' costs of housing amid changing price levels, because payments on fixed interest rate mortgage loans do not change just because there has been inflation, and property taxes and insurance premiums tend to adjust more slowly over time than do measured rents (if not under a rent control regime), which can change continuously as new leases are signed.][14]

4. A provision of the law that does not seem to make much sense is that you need not include, as part of your gross income for federal income tax purposes, the rent received when you rent your house out for less than fifteen days in a year – even a second home, like a vacation cabin. [Contrast that situation with money you find, legally "treasure trove," every penny of which is officially taxable as income (though admittedly most people would not bother to add 10¢ or even $10 to the gross incomes they report if they found money on the ground).] We noted this "Augusta Rule" or "Masters Exemption," which originated with Georgians renting their houses out during the Masters golf tournament, in our Topic 10 discussion. The IRS still treats the property as a "personal residence," so the owner can deduct mortgage loan interest and property taxes within the allowed limits. If renting for 15 days or more in a year, the owner must include all rent received as gross income, but then also qualifies to claim more extensive income property deductions (maintenance, depreciation). Details on what can be deducted can relate to how many days the house is rented out, how many days the owner spends on the premises, and how much of the time spent there is primarily for leisure or primarily to do repairs and maintenance.[15]

5. The state of Illinois does not provide income tax breaks for mortgage loan interest paid (Illinois state income tax is paid essentially on the Adjusted Gross Income shown on the household's federal income tax return; the state does not provide for "below the line" deductions in standard or itemized amounts), but the local *ad valorem* property tax paid on a primary residence in Illinois generates a credit against Illinois state income tax of 5% of the property tax paid. So paying $4,000 in property tax reduces that year's state income tax bill by .05 x $4,000 = $200.

The state's "1stHomeIllinois" plan provides financial assistance with down-payments and closing costs to low or moderate income first-time buyers on existing (not newly-built) houses, and this "grant" does not have to be repaid if the buyer remains living in the house for five years. But at least at one time this program was available only in Boone, Cook, DeKalb, Fulton, Kane, Marion, McHenry, St. Clair, Will, and Winnebago counties. (Other Illinois first-time buyer programs involve interest-free loan assistance that generally must be repaid.) Not surprisingly, other states also use their income tax systems to promote home ownership, and the Federal Home Loan Bank of Chicago provides grants of up to $10,000 to assist moderate income home buyers.

6. A first-time home buyer can withdraw up to $10,000 from an *ordinary* Individual Retirement Account (IRA) to use as a down-payment on a primary residence without paying the early withdrawal penalty that usually accompanies pre-retirement IRA withdrawals, although such a withdrawal counts as income on which income tax must be paid (deposits into ordinary IRAs are deductible, so the withdrawals generally are taxed). But up to $10,000 can be withdrawn from a *Roth* IRA by a first-time home buyer toward a down-payment with no penalty and no income to recognize (because income tax already was paid on money deposited into Roth IRAs), if the Roth account has been in place for at least five years. Two spouses could each withdraw $10,000 under the conditions described toward having $20,000 as a down-payment – and the money also can be used to help a parent, child, or grandchild buy a "first" home (one study found the "dynastic home equity" situation of parents having home equity wealth to draw on increasing the likelihood of their children becoming home owners).[16] [Actually IRS rules generally treat as a "first-time" buyer someone who has not owned a primary residence in the previous two years.]

But any individual can use this provision only once in a lifetime, so if you tap your IRA to help a relative with a down-payment you can not later use money from your IRA for a down-payment on your own "first-time" purchase.

[And money taken from an IRA for home buying purposes can not later be returned to the account; the amount removed is a permanent reduction in the retirement fund balance earning tax-sheltered returns, so people should think carefully before using the IRA down-payment option.]

7. As mentioned earlier, a *credit* is like a super-deduction that directly reduces, dollar for dollar, the income tax otherwise owed, while a deduction merely reduces the income on which tax is to be paid at the applicable rate. (For someone in a 25% marginal income tax bracket, a $100 deduction reduces income tax by .25 x $100 = $25, but a $100 credit reduces income tax by the full $100.) The Energy Policy Act of 2005 reinstated the 1970s oil crisis idea of "residential energy credits," and Congress has continued to allow at least some home energy credits. Until 2034 a home owner can claim a federal income tax credit for 30% of the cost of installing big things that enhance energy efficiency through solar or geothermal or photovoltaic heat systems. There also is a smaller credit for steps like energy-efficient air conditioning, windows, water heaters, insulation, caulking, even fans, maxing out at $500. But claiming these credits reduces the home's tax *basis* (what the owner is deemed to have invested), so in extreme cases they could lead to tax being owed on a capital gain when the home eventually is sold.

Also, low-income home owners may get credits instead of/in addition to deductions for mortgage loan interest paid. A low-income taxpayer who obtains a Mortgage Credit Certificate from a state or local government housing agency can qualify for a federal income tax credit for mortgage loan interest paid. The credit is based on interest paid on a qualifying portion of the debt, and interest amounts applied toward the credit must be excluded from any amount shown as an itemized deduction (which is not likely to affect too many people, since low earners claiming the credit would tend not to have enough in overall deductions to benefit from itemizing). If the credit exceeds the amount owed as taxes, the difference can be carried forward for up to three years.

8. As noted earlier, the dollar amount of debt that is forgiven/not repaid generally counts as taxable income. But the *Mortgage Forgiveness Debt Relief Act of 2007* allowed someone to exclude from income, for federal income tax computation, cancellation of up to $1 million ($2 million for joint return filers) of "qualified principal residence indebtedness" (QPRI) that was obtained to buy/build/improve a principal residence, or the refinancing of such debt. Debt cancellation could come through a loan restructuring or a "short sale" (not the same as the short sales discussed in your investments class). So in an environment of plummeting prices someone owing $350,000 on a house might sell it for only $200,000, and if the bank approves a sale short of the amount owed – a short sale (perhaps to avoid the even bigger costs and headaches of foreclosing) – the $150,000 in forgiven debt is not taxed as income to the borrower. The law was enacted for the 2007 tax year during the mortgage lending and housing crisis, and extended each year through the end of 2017, when it was set to expire for good. But in December of 2019 the provision was extended through 2020, and also made retroactive to cover QPRI debt forgiven in 2018 and 2019, and then in 2021 legislation the break was extended through 2025. (Debt forgiven on other kinds of borrowing, including home equity and even credit card loans, sometimes is excludable from income for tax purposes if the borrower declares bankruptcy or otherwise is found to be insolvent.)

9. Someone who owns a house or estate with historical significance (or other real estate, like a farm or wooded tract) can in some cases donate, to a relevant non-profit or government agency, a *preservation easement* that permanently prevents the demolition of improvements or the development of the land to a different use. Charleston, South Carolina has encouraged owners of historic homes to donate *primary residence easements* to a preservation group, to prevent future purchases by absentee owners.[17] Placing this type of restriction on one's own property theoretically reduces its market value (especially if it is not already in a historic preservation district), and the difference in appraised values without and with the restrictive easement can constitute a charitable contribution that the home owner can deduct from AGI in computing taxable income.

Claiming deductions for such easements (also called conservation easements) has been controversial; typically only wealthy people would be in a position to benefit, and the Internal Revenue Service has charged that appraisals on these unusual properties sometimes have overstated the "before" values and understated the "after" values, to the point that in some cases the donors actually made money by creating the easements. (There are even "syndicated" conservation easements, in which deal organizers buy qualifying properties with money from wealthy investors, and then the tax savings from donating the easements are passed along to the investors.) In fact, a C.P.A.'s letter to the August 10, 2022 *Wall Street Journal* stated that anyone taking this deduction is likely to be audited, and the deduction is likely to be denied by the IRS. But the IRS has generated its own controversies by being found guilty of backdating documents essential to some cases against conservation easement organizers.[18] (On a related point, albeit not with residences: companies that use or produce fossil fuels have purchased conservation easements that prohibit cutting trees on wooded land owned by others, to generate carbon offset credits – driving up lumber prices, economists say, in some cases.)

10. A self-employed individual – not employed by another person or company – who keeps an office at home can claim a business-related deduction against federal tax on the business income. "Separately identifiable space" (not necessarily a separate room) must be used "exclusively and regularly" as the "principal place of business" that is the main location for "administrative or management activities" for a "trade or business" (quoted phrases are IRS terminology); think of someone who repairs appliances at customers' houses but needs a place to accept phone calls, keep records, send bills. [Making money by managing your own investments is not a trade or business.] Under the "actual expenses" method the owner deducts direct costs of maintaining the office during the year (such as painting the office walls); and deducts indirect costs that apply to the whole house (mortgage loan interest and local property taxes [or rent paid], insurance, maintenance/repairs, utility costs) in proportion to the fraction of the house that the office occupies; *e.g*., 15% for a 330 square foot office in a 2,200 square foot house. [IRS materials say that lawn maintenance does not qualify, but if clients visit the office is a mowed lawn not as important as painted walls? The difference could make sense if clients a business operator saw only on Zoom would see the paint, but not the yard.]

Using the actual expenses method requires depreciating the office area's portion of the home over a 39-year period, and that depreciation will be "recaptured" when the home is sold (this tax occurs on resale even if the owner does not deduct depreciation each year, so the tax-saving annual expense might as well be claimed). Under a "simplified method" the self-employed home owner can use a $5 per square foot per year "prescribed rate," on no more than 300 square feet, for a $1,500 maximum yearly deduction. A simplified method user does not have to recognize depreciation and recapture it when the house is sold, and still can itemize deductions on her personal federal tax return for all mortgage loan interest and property tax paid. Either method's deduction is reduced proportionally if the business operates for only part of the year, and while part-time businesses qualify the deduction can not exceed the business's gross income. The rules are somewhat more complicated for a home office located in a separate building on the residential grounds, and for in-home day care businesses. A self-employed person who travels from a qualified home office to do work for clients can also deduct travel mileage from the home location.[19]

11. Personal residence-related income tax breaks from the past (no need to know, but they can be interesting, especially the degree of convoluted detail in some of these bygone initiatives):

a. A controversial credit to spur the housing market, instituted as part of the 2009 federal economic stimulus package, was a federal income tax credit for first-time home buyers of 10% of the home's purchase price (maximum of $4,000 for single filers, $8,000 for married couples, so the credit was $4,000 or $8,000 unless the price was really low). Originally it was scheduled to terminate on November 30, 2009, but Congress then extended it until April 30, 2010 – and added a 10% credit for existing owners who bought replacement homes (maximum of $3,250 for single filers, $6,500 for married couples). Buyer income could be no higher than $125,000 for singles or $250,000 for married couples, the home could cost no more than $800,000, it could not be bought from a relative, and the credit had to be repaid if the home was not used as the claimant's principal residence for at least the subsequent three years (in which case it was essentially an interest-free loan that had to be repaid to the IRS within fifteen years). A "first-time" buyer generally was considered someone who had not owned a home in the previous *three* years. This credit shows the type of short-term boost that lawmakers sometimes try to give housing (President Bush #41 proposed something similar in 1990, but Congress would not pass it). Some observers felt buyers accelerated planned home purchases to meet the April 2010 deadline, thereby merely displacing sales that otherwise would have occurred later.

b. For a few years leading up to 2009 Congress allowed a household that paid property tax on an owned principal residence to claim the regular standard deduction plus an extra amount up to $1,000.

c. Rules for excluding from income a gain on the sale of a residence used to be more complex. Before May of 1997 a gain was untaxed only if the seller replaced the home sold with one at least that expensive within a two-year period. This two-year limit was strictly enforced. Construction delays caused a Florida family to fear their new house would not be finished within two years after the date when they sold their old house. The new structure was fully enclosed, and as the two-year deadline loomed two teenage sons slept on the floor each night (the rest of the family was in an adjacent trailer) to establish a case that family members were "living" there. But with no electricity or running water (recall the importance of cooking and bathroom facilities for qualifying as a residence) the house was deemed by IRS not to be habitable, and a federal judge agreed, so the family was found not to have completed the purchase of a qualifying new residence within the two years – and had to pay a huge tax on the capital gain.

An exception was that a taxpayer aged 55 or older (or a married couple with at least one partner aged 55 or older) could choose, once in the life of a single taxpayer or of either spouse, to exclude forever the tax on a gain of up to $125,000 from a personal residence sale. So "rolling over" with an equally expensive purchase was not necessary

in such a case. But once either member of a married couple had claimed this exclusion, the other spouse could not (and neither could another person that either spouse later married). This "tainted spouse" provision was one that Congress discussed changing, but then the entire law was revamped to create today's much simpler provisions.

d. Prior to TCJA's passage in late 2017 someone who moved to a new primary residence because of a job change generally could treat major moving expenses as an adjustment to income. The new workplace had to be at least fifty miles farther from the original primary residence than the old workplace was, and the move had to take place within about a year of when the new job started. Amounts that could be included were reasonable costs of packing, shipping, and storing personal belongings, and the family's cost of traveling to the new primary residence. [This residence-distance-to-job-related income tax break actually applied to owners and renters alike.]

IV. A Final Point: Using income tax laws to promote home ownership is controversial. Some analysts say that, because renters do not get federal income tax breaks even though they provide money for landlords to pay interest and property taxes, *poor renters* are *subsidizing* more *affluent home owners*. It is interesting that some proponents of a flat-rate income tax system (no graduation in rates, with the same proportion or rate paid as tax on any amount of taxable income) propose terminating the deduction for home mortgage loan interest (which would tend to hurt the higher income people more). But we can also question whether the benefit might be returned to the tenant through a lower rent, in a competitive rental market, than otherwise would be charged, since the landlord saves on federal income taxes by deducting the interest and property tax paid, as business expenses, on the landlord's own business income tax return – and thereby can earn a periodic after-tax rate of return that compensates appropriately for perceived risk, even with lower rents received. ▪

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